APPENDIX A

Opinion of the Court of Appeals

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 72—September Term, 1966.

(Argued December 1, 1966 Decided January 16, 1967.)

Docket No. 30392

SEAS SHIPPING COMPANY, INC.,

Petitioner,

—v.—

COMMISSIONER OF INTERNAL REVENUE

Respondent.

Before:

FRIENDLY, SMITH and ANDERSON,

Circuit Judges.

Petition for review of a decision of the Tax Court of the United States holding petitioner chargeable with a deficiency in its payment of fededal income taxes for the year 1957 because of improper valuation of its block of Moore-McCormack Lines, Inc. stock and because of a deduction for claimed repairs. Judgment affirmed and petition dismissed.

JOHN LOGAN O'DONNELL, Esq., New York, N. Y. (Roger Noall, Esq., Donald F. Johnston, Jr., Esq., and Olwine, Connelly, Chase, O'Donnell & Weyher, of New York, N. Y. on the brief), *for Petitioner.*

LORING W. POST, Esq., Department of Justice, Washington, D. C. (Mitchell Rogovin, Assistant Atty. General, Lee A. Jackson, Esq. and Harry Baum, Esq., Department of Justice, Washington, D. C. on the brief), *for Respondent.*

ANDERSON, *Circuit Judge*:

On March 1, 1957, the taxpayer, Seas Shipping Company, Inc., sold ten ships to Moore-McCormack Lines, Inc. [hereafter Mooremac] for $5,466,668 in cash and notes and 300,000 shares of Mooremac stock. In computing the amount realized from the sale, the taxpayer assigned a fair market value of $19.90 per share to the Mooremac stock. Mooremac resold two of the ships during 1957; and in computing its cost basis relative to the capital gains on the sales of the ships, Mooremac placed a value of $30 per share on the stock. The Commissioner determined deficiencies in the 1957 returns of both the taxpayer and Mooremac, both of whom appealed, and in due course the two matters were heard and decided by the Tax Court. The commissioner did not assert any particular value for the Mooremac stock but took the position that the value had to be the same in both cases. The Tax Court handed down two separate decisions and found as a fact in each

that the value of the stock was $30 per share.[1] The taxpayer has petitioned this court for review of the judgment against it. We affirm.

The Tax Court found that the sale of the ships was an arms' length transaction between knowledgeable parties and therefore appraised the stock by equating its value (plus cash and notes) with the value of the ten ships. To a very large extent it relied upon the evidence of the worth of the ships which it found in the sales contract itself. Although the taxpayer and Mooremac had put no total sales price in the contract, that instrument contained a list of individual dollar values for each ship; these values governed the parties' escrow arrangement, the possibility of *force majeure*, and the removal of ships from the transaction at Mooremac's option. Independent appraisers testified that the 1957 fair market value of the individual ships was as high or higher than the values listed in the contract. When Mooremac resold two of the ships during 1957, it received more than the values listed in the contract; and when the taxpayer sold two other ships, which had been removed from the transaction with Mooremac, it received more for each ship than the values earlier listed in the contract for the same vessels. The Tax Court, therefore, added together the individual ship values listed in the contract, subtracted the amount of cash and notes, and equated the result—$9,000,000—with the total value of the 300,000 shares.

While under the circumstances of this case the Tax Court's adoption of this method of valuation—the equation of two sides of a barter—is not clearly erroneous, it is a

[1] The Tax Court decision in the present case appears at 24 CCH Tax C. Mem. 1222 (1965). The companion case is *Moore-McCormack Lines, Inc.*, 44 T. C. 745 (1965). The opinion in the present case incorporates the findings of fact in the *Moore-McCormack* case to a substantial degree.

means which should be used only under certain limited conditions. The authority for it comes almost exclusively from cases involving valuation of property for which there is little or no market;[2] for example, the leading case of *United States* v. *Davis*, 370 U. S. 65 (1962) involved the purchase by a taxpayer of his ex-wife's inchoate marital rights in his property. There are obvious dangers in evaluating the consideration involved in one side of a barter by determining the worth of the consideration on the other side. In the first place, the two sides of the barter may, for various reasons, not be equal in value. Secondly, the barter-equation method is in the nature of a bootstrap operation since there is usually no logical reason to start with one side rather than the other. The Tax Court might have valued the Mooremac stock first by looking to its trading price on the New York Stock Exchange and then used that figure to compute the fair market value of the ten ships. Thirdly, the evidence on the value of one side of a barter may be no more reliable than that on the value of the other side. The determination of value by this means is particularly complex in a case such as this where the consideration moving from the seller, for example the ships transferred by Seas Shipping, became a part of the assets of Mooremac, the corporate purchaser, in which, as part of the transaction, the seller, Seas Shipping, became a 13% owner. There is nothing to indicate that the Tax Court gave any consideration to this factor.

Although there was a market for Mooremac shares on the New York Stock Exchange which the Government's

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[2] *United States* v. *Davis*, 370 U. S. 65 (1962); *Philadelphia Park Amusement Co.* v. *United States*, 126 F. Supp. 184 (Ct. Cl. 1954); *United States* v. *General Shoe Corp.*, 282 F. 2d 9 (6 Cir. 1960); *Addressograph-Multigraph Corp.*, 4 CCH Tax Ct. Mem. 147 (1945); *Raymond A. Hall*, 10 CCH Tax Ct. Mem. 599 (1951); *Jefferson Livingston*, 18 B. T. A. 1184 (1930); cf., *International Freighting Corp.* v. *Commissioner*, 135 F. 2d 310 (2 Cir. 1943).

stock valuation experts considered satisfactory for establishing fair market value, the Tax Court rejected these sales as having no determinative weight in proving the value of the shares. During 1957 they were traded on the New York Stock Exchange at an average price of $22.81; the total trading volume for the year was 166,000 shares, and the annual high was $25.25. If the taxpayer had resold its 300,000 shares at once, it probably would have received less than the trading price for small volumes—a phenomenon known as "blockage"—since 300,000 shares did not represent a controlling interest. It is for this reason that the taxpayer contends that the correct fair market value of the shares was $19.90.[3] The Tax Court, however, rejected the use of the trading price and blockage as determinants on the ground that an annual market of 166,000 shares was too "thin" to fix the value of a block of 300,000 shares. The court reasoned that a block of that size was worth much more than the sum of the trading prices of 300,000 individual shares because that number of shares constituted a 13% ownership in a successful corporation and was the largest block held by any Mooremac shareholder. The court also thought that the value of the shares to taxpayer was enhanced by virtue of a contemporaneous voting trust agreement which it made with certain Mooremac shareholders by which the taxpayer received control of two directorships on Mooremac's board of ten for a period of five years in return for its promise to vote its shares for the other eight in support of directors selected by the other parties to the agreement.

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[3] The Tax Court disregarded blockage on the ground that the taxpayer-shareholder had no need or intention to liquidate its holdings. The court's underlying assumption—that fair market value is a subjective quality varying with the particular owner of the property—is incorrect. However, there would be no blockage in this case if there were a willing buyer—one who wanted to buy a block of 300,000 shares.

In addition, Mooremac had agreed to continue, under the same name, the shipping line previously operated by the taxpayer and to hire certain of the taxpayer's employees.[4] Finally the court noted that the book value of Mooremac shares during 1957 was in excess of $39.

The Tax Court also attached evidential weight, as admissions by Seas Shipping, to a report made by Mooremac to its shareholders, which was part of the stipulated evidence in the present case, in which Mooremac stated that its stock was worth $30 a share. The court similarly treated (1) a representation made by Mooremac to the New York Stock Exchange that the stock transferred to Seas Shipping had a value of $30 a share; and (2) a statement made by Mooremac in a letter to Seas Shipping which referred to the price of the ships in dollars only. These last two items are not in the evidence nor do they show up anywhere in the record of this case. It appears that they were arbitrarily lifted, together with numerous other findings, out of the companion case of *Moore-McCormack Lines Inc.* v. *C. I. R.*, 44 T. C. 745 (1965), in which counsel for Seas Shipping participated for limited purposes not related to these statements by Mooremac, but in which Seas Shipping was not a party, and incorporated these findings by reference in the present case. This was unsupported by a stipulation of the parties and was done *sua sponte* by the Tax Court itself.[5] This free-wheeling han-

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[4] The court's treatment of the various "collateral rights" as enhancing the value of the stock is curious. It would appear to operate the other way. That is, if the consideration for the ships was paid in cash, notes, stock and other rights, the greater the value assigned to the cash, notes and other rights, the less would be the value assigned to the stock.

[5] In its opinion the Tax Court made the following statement as to its treatment of the two cases:

> "While the record in the instant case contains evidence not introduced in the *Moore-McCormack* case which does tend

dling of the cases has resulted in an incomplete and somewhat disorderly record on review of this case. The petitioner objects that all of these items are unilateral statements by Mooremac and should not have been used against Seas Shipping. Concurring Mooremac's report to its shareholders, the record is barren of any evidence of ratification of or acquiescence by Seas Shipping in the statement, and the other two evidentiary matters were taken from a case in which Seas Shipping was not a party. They should not, therefore, have been considered as admissions by the taxpayer.

Also the court considered the fact that the Maritime Board in its approval of the sale of the ships, stated that the value of the stock was $30 per share. The parties in their briefs interpreted the Tax Court's references to the Maritime Board's approval of the agreement of sale as a conclusion of experts on the value of Mooremac stock. If the Tax Court did so, it was in error. The Maritime Board's own regulation, 46 C. F. R. §284.2(b)(2), states,

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to support the view of petitioner herein that the value of Mooremac stock was less than $30 per share, and although we have given independent consideration to all of the evidence in the instant case in isolation from the evidence presented in the *Moore-McCormack* case, we nonetheless have concluded, and have so found as an ultimate fact, that the Mooremac stock received by petitioner had a fair market value of $30 per share.

We do not deem it necessary to restate here the reasons for our determination. An extensive discussion of the relevant factors is set forth in our report of the *Moore-McCormack* case, and the reasons for concluding as we do on the record in the instant case are in no material respects different than those set forth in Moore-McCormack."[3]

"[3] We recognize that in *Moore-McCormack* we relied in part upon facts of record in that case which were not a part of the record in the instant case. However, the absence of such facts in the instant case is not so material as to require a result here different from that reached in *Moore-McCormack* on the stock valuation question."

"no valuation by the Maritime Administration of a vessel acquired . . . for securities shall be deemed to be a determination . . . of the value of such securities." Also, James Tallman, the official of the Maritime Board who appeared before the Tax Court as a witness, was qualified to testify only as to ship values; and the Board's written statement of the value of the shares, standing by itself, would appear to be incompetent as the opinion evidence of experts on that issue.[6] The Taxpayer, however, has only obliquely raised that point in this court.

If, on the other hand, the Tax Court used the evidence of the approval of the agreement of sale only as proof that Seas Shipping, in accepting the approval, thereby admitted the $30 per share value,[7] then the court was on perfectly sound ground.

While the Tax Court's approach to the valuation of the shares has the infirmities mentioned, it is apparent that the consideration given by the court to the rights accruing to the taxpayer from the contemporaneous voting trust agreement, to the reports by Mooremac to its shareholders and the New York Stock Exchange that the value of the stock transferred was $30 per share, to Mooremac's letter to Seas Shipping to the same effect, and to the valuation of the stock by the Maritime Board at $30 per share, was not a determinative factor in the decision, but was nothing more than additional make-weight. It is wholly unlikely that the exclusion of these items of evidence would have altered the result in any way. Except for Mooremac's unilateral statements, they were not objected to and are only

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[6] See, e.g., *United States* v. *Certain Parcels of Land, etc.*, 261 F. 2d 287 (4 Cir. 1958), discussing in detail the well established rule that tax assessments are not admissible as evidence of value in condemnation proceedings.

[7] Taxpayer did object to the use of this report as evidence of its acquiescenece in the Board's $30 figure.

attacked as part of petitioner's complaint on appeal against the Tax Court's method of evaluating the stock. This court cannot, however, disturb that court's conclusion unless it is clearly erroneous. *Maytag* v. *Commissioner,* 187 F. 2d 962 (10 Cir. 1951).

Although we have found no precedent authorizing the Tax Court to use a barter-equation method where there is an active market for the property to be valued, we cannot say that the court's use of that method in this case was plain error. The character of the small transactions in Mooremac shares on the stock exchange did not reflect many of the aspects of the 300,000 share transfer in question, and we cannot say the Tax Court was clearly wrong in concluding that these small market sales were entitled to little or no weight, certainly not conclusive weight. There was present, therefore, a necessity for the Tax Court to turn to the barter-equation method. Though as more fully stated above we are of the opinion that this method should be used sparingly and with considerable caution, conditions existed which made its use feasible in this case. It is apparent that the evidence persuasively demonstrated the arms' length nature of the exchange and there were also present factors which assured the relative fairness and equality of the considerations passing from each to the other. The testimony concerning the value of the ships was ample and convincing. If the trading price of $22.81 were taken as the stock's value, it would mean that taxpayer had sold its ships for $2,000,000 less than they were worth—a highly unlikely occurrence. Furthermore, there was an additional item of evidence considered by the Tax Court which supported the $30 result reached. In §7(b)(5) of the sales contract, which provided for the release of consideration to Seas by the escrow agent as the ships were delivered, the parties themselves assigned a value of $30 per share to the stock. Where parties with

adverse interests are at issue over the worth of property and then agree upon the dollar amount of that worth, the agreement is very persuasive evidence of value. *Ullman* v. *Commissioner*, 264 F. 2d 305, 308 (2 Cir. 1959).

The Taxpayer also seeks review of the Tax Court's decision about another item in its 1957 return. In August 1956, the Commandant of the United States Coast Guard ordered all vessels of a certain type to be "strapped," that is, provided with a reenforcing horizontal steel band attached to the skin of the ship, to give it additional strength and prevent cracking of the hull. During 1957 the taxpayer strapped four of its ships, and deducted the cost as a repair expense. The Tax Court, without deciding whether the strapping increased the value or useful life of the vessel, held that strapping was a capital expenditure and that it was therefore not deductible as a repair expense. The line between capital and current expenses is often a difficult one to draw, and Courts of Appeals should not overturn decisions of the Tax Court on this question unless they are manifestly wrong. *P. Dougherty Co.* v. *Commissioner*, 159 F. 2d 269, 272 (4 Cir. 1946), *cert. denied*, 331 U. S. 838 (1947). Here the strapping was a nonrecurring expenditure of a purely preventative nature, the benefits of which were to stretch out over the lifetime of the ship. There is no reason to disturb the decision of the Tax Court on that question.

Its decision is affirmed and the petition is dismissed.

FRIENDLY, *Circuit Judge* (concurring):

While I wholly approve the result reached by my brothers, the case seems much easier to me than it did to the Tax Court or does to them.

When these two companies sat down to negotiate the

sale of the Seas Shipping fleet to Mooremac, it must have been obvious to them and their experienced counsel that the seller's interest would be served by a lower and the purchaser's by a higher valuation of the Mooremac stock —in the case of the latter not only to obtain a high tax basis but for purposes of its operating-differential subsidy, 46 U.S.C. ch. 27, subchapter VI, 46 C. F. R. Part 284. It should have been equally obvious that the Commissioner of Internal Revenue could not be expected to tolerate a state of affairs in which Seas had the benefit of a lower figure and Mooremac of a higher one. The Sales Agreement set values for ten vessels, in addition to the two that were to be paid for in cash, and provided that upon delivery of each, Mooremac stock should be issued to Seas "at the rate of one full share for each $30, or fraction thereof, of value of the Vessels . . .," with any balance payable in cash or serial notes at Mooremac's option. The contract was subject to approval by the Federal Maritime Board and/or the Maritime Administration. The Board's letter of approval endorsed the values the parties had assigned to the vessels and referred to the Mooremac stock as being taken "@ $30.00 per share"; the Board requested each company to signify its "unqualified acceptance." When the parties joined in a telegram asking the Board to delete the figure for the stock and simply refer to the agreement, an official refused, telling Seas' lawyer "that the proposal was unacceptable because of Federal Maritime Board requirements." Seas and Mooremac thereupon returned their acceptance, Seas contenting itself with a letter agreement with Mooremac which confirmed their understanding that the terms and conditions of the basic agreement remained unchanged.

To be sure, none of these arrangements would have precluded the Commissioner, who was not a party, from asserting that the Mooremac stock was not worth $30 per

share if he had been so advised.[1] But if he was satisfied to leave the parties in the bed they and the maritime regulatory agency had made, I fail to perceive any legitimate basis for one of them to complain. The situation is indeed somewhat reminiscent of the tax problems in allocating proceeds of a sale between assets or stock and a covenant not to compete, where, as Judge Waterman said in *Ullman* v. *C. I. R.*, 264 F. 2d 305, 308 (2 Cir. 1959), the tax desires "of the buyer and seller . . . are ordinarily antithetical, forcing them, in most cases, to agree upon a treatment which reflects the parties' true intent with reference to the covenants, and the true value of them in money" so that "strong proof must be adduced . . . in order to overcome that declaration." See, accord, *Hamlin's Trust* v. *C. I. R.*, 209 F. 2d 761, 765 (10 Cir. 1954); *Montesi* v. *C. I. R.*, 340 F. 2d 97, 100 (6 Cir. 1965). This is *a fortiori* true when the parties' declaration has been approved, indeed particularized and insisted upon, by an expert agency of government that has administered the payment of subsidies to both.

[1] The provision in 46 C. F .R. §284.2(b)(2), "No valuation by the Maritime Administration of a vessel acquired in whole or in part for securities shall be deemed to be a determination by the Maritime Administration of the value of such securities," was doubtless intended to prevent argument on this score.

APPENDIX B

Opinion of the Tax Court—*Seas Shipping Co.*, 24 CCH Tax Court Mem. 1222 (1965)

(1222)

T. C. Memo 1965—240

TAX COURT OF THE UNITED STATES

Seas Shipping Company, Inc., Petitioner v. Commissioner of Internal Revenue, Respondent.

Docket No. 3105—62. Filed August 31, 1965.

1. Petitioner sold 10 ships to Moore-McCormack Lines, Inc., for cash, notes and 300,000 shares of Moore-McCormack stock. Said 300,000 shares constituted 13 percent of Moore-McCormack's outstanding stock thereafter. *Held*: For purposes of determining petitioner's gain on the sale of its ships, the 300,000 shares received had a value of $30 per share. *Moore-McCormack Lines, Inc.*, 44 T. C. 745 (August 27, 1965), a companion case involving the same question of fact, followed.

2. *Held*: Petitioner is entitled to a deduction for depreciation, including depreciation on all capitalized improvements, on the vessels sold from the beginning of the taxable year until the dates of sale, even though the sales price was in excess of the adjusted bases of the vessels at the beginning of the year. *Macabe Co.*, 42 T. C. 1105 (1964), on appeal to C. A. 9, February 12, 1965, followed.

2. *Held*: The cost of "strapping four vessels was a capital expenditure and not a deductible repair expense.

Richard H. Appert and *David Sachs*, for the petitioner.

George T. Rita, for the respondent.

Opinion of the Tax Court—Seas Shipping Co., 24 CCH Tax Court Mem. 1222 (1965)

MEMORANDUM FINDINGS OF FACT AND OPINION

HOYT, Judge: Respondent has determined a deficiency in petitioner's income tax for the calendar year 1957 in the amount of $1,476,539.74.

The issues for decision are:

(1) What was the fair market value, for purposes of computing the correct amount of gain on sale, of a block of 300,000 shares of Moore-McCormack Lines, Inc., stock received by petitioner as part of the con-

(1223)

sideration for the sale of ten ships to Moore-McCormack Lines, Inc.?

(2) Is petitioner entitled to a deduction for depreciation on ten vessels in the year in which those vessels were sold for a price in excess of their adjusted basis as of the beginning of that year?

(3) Did the cost of "strapping" four vessels constitute a repair or a capital expenditure?

FINDINGS OF FACT

Some of the facts have been stipulated and are hereby adopted as our findings. The stipulation and exhibits attached thereto are hereby incorporated by reference.

Petitioner is a New York corporation with its principal office in New York City. Its 1957 calendar year income tax return was prepared on the accrual basis and filed with the district director of Internal Revenue for the then Lower Manhattan District. Petitioner was engaged, at the time of the transaction involved herein, in the business of owning and operating ships in international commerce.

Opinion of the Tax Court—Seas Shipping Co., 24 CCH Tax Court Mem. 1222 (1965)

Facts Related to the Sale of Ten Ships to Moore-McCormack Lines, Inc.

Reference is made to the report of the case of *Moore-McCormack Lines, Inc.*, 44 T. C. 745 (Aug. 27, 1965); all findings of fact in such report under the hearing *"Facts Common to This Case and to Docket No. 3105—62, Seas Shipping Company, Inc.,"* are hereby found and such findings are incorporated herein by this reference.

Prior to 1957 petitioner operated the Robin Line under a subsidy agreement with the Federal Maritime Board. In late 1956 negotiations between petitioner and the Maritime Board for renewal of the subsidy agreement broke down and petitioner determined that it would have to sell its fleet of ships. Petitioner wished to sell all its ships to a single purchaser who could continue with its established trade routes and would employ the petitioner's employees.

After the agreement with Mooremac was reached the parties applied to the Maritime Board for approval of the proposed sale. In its letter of approval, the Maritime Board referred to the Mooremac stock as to be "issued to Seas at $30.00 per share."

The petitioner objected to this language in the Maritime Board's letter and, together with Mooremac, sent a telegram to the Board requesting that the letter of approval be amended in such a way as would have eliminated the reference to a $30 price per share. The Maritime Board refused to change its letter,[1] and the petitioner ultimately accepted it upon advice of counsel that the valuation of the shares for tax purposes would not be affected thereby.

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[1] The record does not indicate why the Maritime Board refused the requested change.

Opinion of the Tax Court—Seas Shipping Co., 24 CCH Tax Court Mem. 1222 (1965)

In conjunction with the proposed sale of ships by petitioner to Mooremac the Ship Valuation Committee of the Federal Maritime Administration was asked to determine whether the proposed prices to be paid by Mooremac were "within the present market values" of the ships to be purchased. In a report of April 10, 1957, the Committee listed the then-current domestic market values as follows:

Robin Locksley	$1,300,000
Robin Sherwood	1,300,000
Robin Tuxford	1,300,000
Robin Wentley	1,300,000
Robin Doncaster	1,300,000
Robin Kettering	1,300,000
Robin Goodfellow	1,650,000
Robin Gray	1,650,000
Robin Hood	1,650,000
Robin Kirk	1,650,000
Robin Mowbray	1,650,000
Robin Trent	1,650,000

Without the shareholders' agreement entered into by petitioner and other principal stockholders of Mooremac contemporaneously with the contract of sale, petitioner would not have been assured of any representation on Mooremac's board of directors since the 300,000 shares received represented less than 50 percent of the outstanding stock and Mooremac did not have cumulative voting.

The promissory notes of Mooremac received by the petitioner had a fair market value equal to their par or face value.

Petitioner took the Mooremac stock under a representation that it was acquiring the shares solely for investment and not with a view to the resale or further distribution thereof. The shares so received were not registered with the Securities and Exchange Commission.

The highest price at which Mooremac stock has ever been traded on the New York Stock Exchange is 25¼, reached in January and February of 1957. However, the stock has traded as low as 17 in December 1957, and 10⅝ in 1960.

(1224)

The book value per share and the high and low selling prices on the New York Stock Exchange of the common stock of two other corporations which are also engaged in the business of owning and operating ships in international commerce were as follows at the times indicated:

		Book Value Dec. 31	High Selling Price	Low Selling Price
American Export Lines, Inc.	1956	$53.03	$30⅛	$17⅜
	1957	59.11	31¼	19¼
United States Lines Company	1956	$46.65	$36¾	$22⅝
	1957	49.67	37⅛	22½

The petitioner sold the SS Robin Kettering and the SS Robin Doncaster, the two ships which had been excluded from the sale to Moore-McCormack, to Isbrandtsen Company, Inc., for cash and mortgage notes (at face value) in the aggregate amount of $1,350,000 for each ship. Said mortgage notes had a fair market value equal to their face value and were not disposed of by the petitioner at a dis-

count. The petitioner paid selling commissions in the amount of $40,625 with respect to each of these two ships.

Other sales of similar vessels were made at or about the same time at comparable prices. The fair market values of the ships sold by Seas to Mooremac were at least the amounts of the assigned contract values.

In its income tax return for 1957 petitioner reported the sale of its fleet of vessels as resulting in a long-term capital net gain of $6,440,627.17. In his notice of deficiency respondent increased the total net gain to $11,305,594.46. A portion of this income was due to respondent's action in placing a value of $39.17 per share on the 300,000 shares of Mooremac stock received by petitioner as part payment for the ships.

No explanation for the $39.17 per share valuation ascribed to Mooremac's stock by the respondent is made but it apparently derives from the fact that the stock had a book value of approximately that amount throughout 1957.

Finding of Ultimate Fact

The 300,000 shares of Mooremac stock received by petitioner as part payment for the ten Robin Line ships sold to Mooremac in 1957 had a fair market value of $9,000,000, or $30 per share.

Facts Related to Depreciation in the Year of Sale

The 12 ships which were sold by the petitioner[2] were used in its trade or business during the course of the year

[2] Including the two ships excluded from the Mooremac sale and later sold to a third party. No issue is raised as to the correct amount of gain on the sale of these two vessels, however, respondent has disallowed depreciation in the year of sale on all 12 vessels sold in 1957, including the two not sold to Mooremac.

1957 from January 1st to the date of sale of each respective ship. From the time of acquisition of the 12 ships, the petitioner adopted a consistent policy of depreciating them, for accounting and tax purposes, on a straight-line basis, using a useful life of 20 years from the date of construction and a salvage value of 2½ percent of cost. Similar depreciation bases are used by owners of similar subsidized vessels. The useful life and salvage values were prescribed under General Order No. 24 of the Maritime Board. In a closing agreement between the taxpayer and the respondent proposed in 1947, such depreciation bases were approved as proper for Federal income tax purposes. In a letter of the respondent dated July 7, 1947, interpreting the closing agreement, it was specifically provided that:

> It is intended by Article VIII of the closing agreement to provide an annual depreciation rate consistent with the Maritime Commission's treatment of subsidized vessels as having a total useful life of 20 years from construction (Maritime Commission General Order No. 24) or an appropriately higher annual rate for vessels acquired after the expiration of a portion of such life. * * *

Under the subsidy agreement between the petitioner and the Maritime Board, the Board would not subsidize any of petitioner's vessels after they were 20 years old. Only once in the history of the petitioner

(1225)

was it permitted to use a vessel longer than 20 years. This was allowed in a shipping emergency in 1939. The Maritime Board permitted the vessel to be used for only one voyage after its twentieth year, in a special amendment to

the subsidy agreement in which a finding was made "that a period of actual emergency exists."

Petitioner computed depreciation, in accordance with the method described above, for the period from January 1, 1957, to the date of sale of each vessel, and depreciation so computed was deducted in petitioner's 1957 return. This deduction was disallowed by respondent.

In 1954 and 1956 petitioner incurred costs with respect to 8 of its 12 ships which subsequently were classified by respondent as capital expenditures without contest by petitioner. No depreciation was taken in petitioner's 1957 income tax return with respect to these capital expenditures incurred in 1954 and 1956, and respondent made no allowance for depreciation on these items in his notice of deficiency.

The date of acquisition, original cost bases, dates and amounts of capital improvements, and 1957 depreciation to date of sale for all 12 ships sold in 1957 are summarized in the following table:

	Date of Acquisition	Original Cost	Date of Capital Addition	Cost of Capital Addition	Adjusted Bases Jan. 1, 1957	1957 Depreciation on Original Cost to Date of Sale	1957 Depreciation on Capital Additions to Date of Sale
SS Robin Doncaster	2/16/48	$ 1,322,461.32			$ 488,212.83	$ 57,903.46	
SS Robin Goodfellow	2/27/47	1,602,568.80	7/1/54	$ 10,890.00	787,621.32	36,307.29	$ 453.75
SS Robin Gray	7/22/47	1,704,769.84	12/1/56	49,830.00	788,271.90	46,811.93	3,235.70
SS Robin Hood	2/25/47	1,660,510.68			810,152.16	40,603.66	
SS Robin Kettering	5/13/48	1,334,930.03	7/1/54	6,639.00	521,081.51	58,162.02	553.28
SS Robin Kirk	12/29/47	2,456,677.79			1,087,904.08	89,025.90	
SS Robin Locksley	3/ 5/41	1,395,344.17	7/1/54	10,337.00	370,057.24	32,048.03	738.36
SS Robin Mowbray	7/16/48	2,441,011.06			1,123,078.89	58,839.86	
SS Robin Sherwood	7/16/41	1,393,035.31	7/1/54	3,755.00	388,690.84	26,922.47	223.50
SS Robin Trent	3/31/48	2,458,229.78	6/1/56	25,491.09	1,150,784.85	53,164.80	3,515.12
			10/1/56	45,161.00			
SS Robin Tuxford	9/22/41	1,397,922.16	7/1/54	14,500.00	410,770.13	32,328.44	1,075.72
SS Robin Wentley	11/ 3/41	1,390,636.90	7/1/54	18,704.44	419,906.55	40,382.56	1,356.11
Totals		$20,558,097.84		$185,307.53	$8,346,532.30	$572,500.42	$11,151.54

Opinion of the Tax Court—Seas Shipping Co., 24 CCH Tax Court Mem. 1222 (1965)

Facts Related to "Strapping" of Vessels

During the year 1957, prior to their sale, petitioner made expenditures for "strapping" four of its ships, as follows:

Ship	*Cost*
SS Robin Goodfellow	$ 47,000.00
SS Robin Hood	45,000.00
SS Robin Kirk	44,074.24
SS Robin Mowbray	48,217.00
	$184,291.24

As a result of an investigation of shipping casualties involving C-3 type vessels the Commandant of the United States Coast Guard, on August 24, 1956, issued a directive requiring "strapping" of certain vessels, including those of the C-3 type operated by petitioner. A ship of the type covered in the Coast Guard directive, presumably even a brand new one, could not be operated in commerce if it were not strapped.

"Strapping" consists of the attachment by riveting or welding of a steel band about three feet wide and three quarters of an inch thick along the sides or deck of a vessel in longitudinal direction. The purpose of strapping is to strengthen the vessel and prevent cracking of the hull.

Petitioner in its 1957 return deducted the cost of strapping the four vessels as

(1226)

a "repair" expense. Respondent disallowed the deduction on the ground that strapping constituted a capital expenditure and not a deductible expense. In making the adjust-

ment respondent made no allowance for depreciation of the strapping expenditures in 1957 to the dates of sale of each vessel.

Opinion

The first issue in this case is a determination of the amount of gain realized by petitioner upon the sale of the Robin Line ships to Mooremac. Gain from sale of property is the excess of the amount realized over the adjusted basis. Section 1001(a), Internal Revenue Code of 1954. The amount realized is the sum of any money received plus the fair market value of property other than money received. Section 1001(b), Internal Revenue Code of 1954. In the instant case petitioner received property other than money in the form of notes and stock in Mooremac. The notes were stipulated to have a fair market value equal to their face value, but there is considerable disagreement between the parties as to the fair market value of the Mooremac stock received.

The question of the valuation of this block of 300,000 shares issued by Mooremac to petitioner in partial payment for the purchase by Mooremac of the Robin Line ships has already been considered by this Court in *Moore-McCormack Lines, Inc.*, 44 T. C. 745 (1965), Docket No. 2887—62. In that case the issue arose as a result of the sale by Mooremac of two of the Robin Line ships shortly after the purchase from Seas, and the necessity to determine the cost basis to Mooremac of these ships which were resold. Since the cost basis was the value of the money and property given up in exchange for the ships it became necessary to determine the value of the shares of Mooremac stock issued in partial payment therefor. We there determined that the shares issued to Seas had a fair market

value of $30 per share, as reported by Mooremac. While the record in the instant case contains evidence not introduced in the *Moore-McCormack* case which does tend to support the view of petitioner herein that the value of Mooremac stock was less than $30 per share, and although we have given independent consideration to all of the evidence in the instant case in isolation from the evidence presented in the *Moore-McCormack* case, we nonetheless have concluded, and have so found as an ultimate fact, that the Mooremac stock received by petitioner had a fair market value of $30 per share.

We do not deem it necessary to restate here the reasons for our determination. An extensive discussion of the relevant factors is set forth in our report of the *Moore-McCormack* case, and the reasons for concluding as we do on the record in the instant case are in no material respects different than those set forth in *Moore-McCormack*.[3]

Petitioner here makes three basic arguments in support of its claimed valuation of $19.90 per share. The first of these is a contention that we should consider the effect on market value of the so-called "blockage" involved in the instant situation. "Blockage" is a term used to characterize the depressing effect on the market price of a stock traded on a stock exchange caused by sale of a large block substantially in excess of the normal level of trading. The necessity to liquidate such a block is likely to depress prices because it creates an available supply far in excess of normal demand. Petitioner contends that the value of the block received should be based upon the price that

[3] We recognize that in *Moore-McCormack* we relied in part upon facts of record in that case which were not a part of the record in the instant case. However, the absence of such facts in the instant case is not so material as to require a result here different from that reached in *Moore-McCormack* on the stock valuation question.

could be received if the block were liquidated in the market and that this price would be below prevailing market prices because of the blockage factor.

There is no doubt that the 300,000 shares here involved would depress market prices if liquidated; only 166,000 shares of Mooremac were traded on the stock exchange in all of 1957. However, this fact is of little relevance in the instant situation. Petitioner at no time had either the need or the intention to liquidate the shares received. Its intention was to remove itself from the business of operating a shipping line and to own instead a substantial share of a larger shipping company which would take over its fleet. The contract of sale itself states that Seas was to hold the stock for investment. The collateral stockholders' agreement assuring petitioner representation on Mooremac's board of directors is clearly inconsistent with a contemplated

(1227)

liquidation by petitioner of the shares received. At the time of trial in the instant case petitioner continued to own the Mooremac stock. It is clear in these circumstances that blockage is not a factor in the instant case.

Petitioner's expert witness, an investment banker who determined a $19.90 per share value after considering the blockage factor, testified on cross-examination that blockage is not a factor when there is no intent to liquidate the block.[4] In *Safe Deposit & Trust Co. of Baltimore*, 35

[4] Q. You sell me three hundred thousand and I buy it. We have a willing buyer and a willing seller. You say there is no blockage? A. That is right.

Q. The buyer wants to hang on to that because he likes that stock. You still don't have any blockage do you? A. Not if he wants to hold on to it. We are dealing with a problem of realization of fair market value.

B. T. A. 259 (1937), affd. 95 F. 2d 806 (C. A. 4, 1938), this Court arrived at a valuation below the stock exchange mean price but qualified our finding as follows at page 263:

> This conclusion has not been arrived at by any dogmatic recognition or nonrecognition of any so-called "blockage" rule, i.e., that a large block of shares of one kind is *ipso facto* to be valued with or without relation to the value of one share in a smaller block. "Blockage" is not a law of economics, a principle of law, or a rule of evidence. If the value of a given number of shares is influenced by the size of the block, this is a matter of evidence and not of doctrinaire assumption.

In light of the fact that petitioner had neither intention nor need to liquidate the 300,000-share block, we hold that the size of the block in the instant case is evidence not that "blockage" is applicable, but, rather, that the per share value is greater than the mean stock exchange price. *Frank J. Kier,* 28 B. T. A. 633 (1933).

Petitioner's second contention is that the agreement of sale did not determine the fair market value of the shares, even though the shares were assigned a value of $30 in the agreement. We agree that the value assigned in a contract of sale is not necessarily determinative of the actual fair market value. See *Carl L. Danielson,* 44 T. C. 549 (July 12, 1965). However, when two parties dealing at arm's length assign a value to an item of property being sold or exchanged, and such value has economic significance in the sale or exchange, the value so assigned is very persuasive as to the true fair market value. *Elmhurst Cemetery Co. of Joliet* v. *Commissioner,* 300 U. S. 37 (1937), affirming a Memorandum Opinion of this Court; *Ullman* v. *Commis-*

sioner, 264 F. 2d 305, 308 (C. A. 2, 1959), affirming 29 T. C. 129 (1957); *Simons Brick Co.* v. *Commissioner,* 45 F. 2d 57 (C. A. 9, 1930), affirming 14 B. T. A. 878; *Hinkel* v. *Motter,* 39 F. 2d 159 (D. C. Kan., 1930), appeal dismissed, 42 F. 2d 1018 (C. A. 10, 1930). It is by now axiomatic that fair market value is the price that would be paid by a willing buyer to a willing seller, neither acting under any compulsion. *Estate of Williams,* 256 F. 2d 217 (C. A. 9, 1958), affirming a Memorandum Opinion of this Court, and cases cited therein at footnote 1; *Edwin M. Brown,* 1 B. T. A. 502 (1925). In the instant case, Mooremac (a willing "seller") and petitioner (a willing "buyer"), assigned a value of $30 per share; there is no evidence to indicate that the parties were not dealing at arm's length or that petitioner was compelled to accept the $30 valuation.

Petitioner does contend, however, that it accepted the $30 valuation merely as an accommodation to Mooremac, and that it never regarded the stock as actually worth $30 a share. Petitioner's president testified that he was advised by counsel that the $30 valuation figure used in the contract had significance only as a means of allocating the total consideration paid by Mooremac among the ten ships sold to it, and that acceptance of the $30 valuation would not constitute a determination by petitioner that the stock was actually worth $30 per share for tax or any other purposes. A comparable argument was made in *Ullman* v. *Commissioner, supra,* in which the consideration allocable to a covenant not to compete was in question. There the court stated:

> Petitioners' argument that they never negotiated as to a value for the covenants, thereby implying that the treatment of them was a unilateral action on the

(1228)

part of Consolidated, noticed only casually by themselves, is also without support.

Similarly, in the instant case we find petitioner's assertions highly improbable and without support.

Under our analysis of the terms of the contract of sale we cannot accept the argument that the $30 assigned value had no economic significance to petitioner and was merely intended as a means for allocating the total consideration among the ten ships. In the contract of sale a dollar value was assigned to each ship, and it was provided that Mooremac stock could be paid to petitioner at a rate of one share for each $30 of assigned value—up to the 300,000 total shares to be issued. The total consideration to be given by Mooremac was 300,000 shares and $4,800,000 in cash and/or notes. The total value assigned to the ten ships sold was $13,800,000. Thus, each share represented $30 of assigned ship valuation. This means that if the values assigned to the ships reflect true values, then $30 value assigned to each share reflects the true value of the shares, assuming the exchange was a *quid pro quo*.

Despite petitioner's assertions to the contrary, we find no basis in the record to hold that petitioner received anything less than equivalent fair value for the ships sold. The record simply does not support petitioner's contention that its fleet was sold at a sacrifice price. Hence, if the values assigned to the ships sold reflect true market values, the $30 value of the shares to be issued in exchange therefor in a *quid pro quo* exchange represents the fair value of those shares. We are satisfied from the evidence of record outside of the contract of sale itself that the values assigned to the ships in the contract do in fact represent true fair market values.

Petitioner's third argument is that the values of the ships sold are not significant in determining the value of the stock received. Citing several cases, it contends that the value of property given up is not to be referred to in valuing property received in exchange therefor when the property received has a readily ascertainable value of its own, and here the Mooremac stock received has an independent value based on stock exchange prices. Petitioner quotes the following passage from *United States* v. *Davis*, 370 U. S. 65, 72 (1962):

> *Absent a readily ascertainable value* it is accepted practice where property is exchanged to hold, as did the Court of Claims in *Philadelphia Park Amusement Co.* v. *United States*, 126 F. Supp. 184, 189 (1954), 130 Ct. Cl. 166, 172, that the values "of the two properties exchanged in an arms-length transaction are either equal in fact, or are presumed to be equal." (Emphasis added by petitioner.)

From this it is argued that where there *is* a readily ascertainable value for the asset received no reference should be made to the value of the asset given up.

The other cases cited by petitioner are not helpful here since they assume that there *is* a readily ascertainable value for the stock received. If this were the case here this opinion would have been concluded several pages ago. The very problem before us is that the 300,000 shares received by petitioner do *not* have a readily ascertainable value independent of evidence of the value of the ships given up in arm's-length exchange therefor.[5] We hold that the value

[5] As already discussed, the per share stock exchange price of Mooremac stock does not represent a readily ascertainable value in the instant case because of the very large block involved here, and the fact that the stock exchange market was a very thin one.

of the ships may be considered as evidence of the value of the ships may be considered as evidence of the value of the stock received in exchange therefor. *United States* v. *Davis, supra.*

On the basis of the entire record in this case and using our best judgment to weigh and evaluate all of the evidence before us, we have found as an Ultimate Fact and here hold that the fair market value of the block of 300,000 shares of Mooremac stock received by petitioner in 1957 was worth $9,000,000, or $30 per share. *Moore-McCormack Lines, Inc., supra.*

The second issue in this case involves the deductibility of depreciation in the year of sale.* Respondent's sole reason for disallowing the depreciation claimed is that the amount received by petitioner for the vessels sold was in excess of petitioner's undepreciated or adjusted basis in the vessels as of the beginning of the year of sale. It is respondent's position that under such circumstances no deduction for depreciation is allowable as a matter of law.

In several recent court-reviewed opinions this Court held that there is no such rule

(1229)

of law. *Harry Trotz,* 43 T. C. 127 (1964); *Smith Leasing Co.,* 43 T. C. 37 (1964), on appeal to C. A. 5, March 5, 1965; *Macabe Co.,* 42 T. C. 1105 (1964), on appeal to C. A. 9, February 12, 1965.

We have been able to find nothing in the record before us to indicate that the useful life and salvage values used by petitioner in his depreciation schedules for these vessels were inaccurate or that gain realized by petitioner in connection with their sales did not, in its entirety, result from market depreciation. *Harry Trotz, supra.* In fact,

* [Note to this Appendix: The Tax Court's decision on this issue is not on appeal.]

the depreciation schedules used in this case were prescribed by the Maritime Board and approved by respondent. Respondent has never sought to change either useful life or salvage value, and we must conclude that they were correctly and properly estimated and computed, accurate and reasonable.

Respondent relies upon the following authority for its contention that where an asset is sold for a price in excess of its adjusted basis at the beginning of the year no depreciation is allowable to the date of sale. *Hertz Corporation* v. *United States,* 364 U. S. 122 (1960); *Fribourg Navigation Co.* v. *Commissioner,* 335 F. 2d 15 (C. A. 2, 1964), affirming a Memorandum Opinion of this Court, certiorari granted February 1, 1965; *Cohn* v. *United States,* 259 F. 2d 371 (C. A. 6, 1958); *Edward V. Lane,* 37 T. C. 188 (1961); *Randolph D. Rouse,* 39 T. C. 70 (1962); Rev. Rul, 62-92, 1962-1 C. B. 29.

Of course, we are fully aware that the deductibility of depreciation in the year of sale is currently one of the most avidly discussed controversies in tax law.* We do not deem it necessary to render a magnum opus discussing all the prior cases, the arguments typically advanced by both sides, and the theories propounded by the growing array of judges and commentators who have expressed themselves on this issue. Suffice it to say that although this case involves merchant ships, as did *Fribourg Navigation, supra,* the similarity factually between the two cases is only superficial. In our view, the facts in the instant case are sufficiently different to warrant a different result here than was reached in *Fribourg.* We believe that petitioner is entitled to deduct depreciation on its vessels used in its business operations during 1957 to produce taxable

* [Footnote by the Tax Court omitted.]

income that year on the same basis upon which it was allowed without question for former years, and as it would have been allowed for 1957 if no sale of the vessels had occurred. Our determination here is governed by our decision in *Macabe Co., supra,* and the cases relied upon by respondent are not controlling on the facts before us here for the same reasons the same cases were not regarded as controlling in *Macabe.*

The factual situation in the instant case is strikingly similar to the facts relied upon by the Eighth Circuit in *United States* v. *S & A Company,* 338 F. 2d 629 (C. A. 8, 1964), certiorari applied for January 27, 1965, in holding for the taxpayer, to wit:

> * * * unanticipated and non-customary sale in mid-life of a depreciable asset; acceptance of the correctness and reasonableness of the taxpayer's acquisition estimates of useful life and salvage value; actual approval of depreciation based on this estimate in prior years, some of which still remained open, and the inescapable inference that the claimed depreciation would have been allowed for the sale year had the sale not taken place * * *

We conclude that the depreciation claimed by petitioner and the depreciation on the

(1230)

capitalized improvements is deductible in full. *United States* v. *S & A Co., supra*; *Harry Trotz, supra*; *Macabe Co., supra.*

The final issue for decision is whether the costs incurred by petitioner in 1957 for strapping four vessels are deductible as a repair or must be capitalized. The regulations under section 162 of the 1954 Code set forth

the following standards for determining whether an expenditure with respect to a capital asset is deductible as a repair expense or must be capitalized:

> Section 1.162 Statutory provisions; trade or business expenses.
>
> • • •
>
> Section 1.162-4 Repairs.
>
> The cost of incidental repairs which neither materially add to the value of the property nor appreciably prolong its life, but keep it in an ordinarily efficient operating condition, may be deducted as an expense, provided the cost of acquisition or production or the gain or loss basis of the taxpayer's plant, equipment, or other property, as the case may be, is not increased by the amount of such expenditures. Repairs in the nature of replacements, to the extent that they arrest deterioration and appreciably prolong the life of the property, shall either be capitalized and depreciated in accordance with section 167 or charged against the depreciation reserve if such an account is kept.

Petitioner places primary reliance on *Illinois Merchants Trust Company,* 4 B. T. A. 103 (1926), acq. V-2 C. B. 2, and *Plainfield-Union Water Company,* 39 T. C. 333 (1962), non-acq. 1964-2 C. B. 8, and cases discussed therein. In *Illinois Merchants Trust Company, supra,* this Court allowed as a repair expense the cost of replacing rotted wooden pilings, upon which a building rested, with concrete pilings to prevent its collapse. In *Plainfield-Union Water Company, supra,* we held deductible the cost of cleaning and lining cast iron water pipes with cement in order to arrest and prevent a form of corrosion. While

we find these cases and several others discussed in *Plainfield-Union* to be of considerable weight in support of petitioner's position herein, we find all of the authority relied upon by petitioner to be distinguishable from the factual situation present in the instant case. Furthermore, we find that the authority relied upon by respondent is more exactly in point and in many cases indistinguishable from the situation before us.

In *Marble & Shattuck Chair Co.* v. *Commissioner,* 39 F. 2d 393 (C. A. 6, 1930), affirming 13 B. T. A. 657 (1928), expense incurred in bricking up certain windows for the purpose of strengthening a wall was held to be capital in nature. In *Black Hardware Co.* v. *Commissioner,* 39 F. 2d 460 (C. A. 5, 1930), affirming 16 B. T. A. 551 (1929), certiorari denied 282 U. S. 841 (1930), it was held that the cost of raising the floor of a hardware company to protect it against flood was a capital expense. The Fifth Circuit, in affirming, described our opinion as follows (at page 461):

> * * * the Board of Tax Appeals reached the conclusion that, while the improvements did not prolong the life of the building, nor increase its value as a building, it became more valuable for the use of petitioner in his business, as the improvements are a protection against damage from future storms. The Board held that the raising of the floor and subsequent rearrangement of the fixtures amounted to improvements and betterments, and should be added to the petitioner's capital investment and not be deducted as business expenses for the taxable year.

A notable difference between these cases (and others relied upon by respondent, discussed *infra*) and those relied on by petitioner is that petitioner's cases all involve

expenditures to correct an existing defective condition, whereas respondent's cases involve "preventive" improvements. It is true that in *Illinois Merchants Trust Co., supra,* and *Plainfield-Union Water Co., supra,* the improvements had the effect of preventing the damage from recurring, or at least, arresting its progress. However, it is also true that the improvements corrected existing defects which had to be dealt with.

In the cases relied on by respondent there were no existing defects; the improvements were designed not to correct but solely to prevent the future occurrence of a defect. Petitioner in its brief quotes a paragraph from our opinion in *Illinois Merchants Trust Co., supra.* The following portion of that paragraph is significant here:

> To repair is to *restore* to a sound state or to *mend,* while a replacement connotes a substitution. A repair is an expenditure for the purpose of keeping the property in an ordinarily efficient operating condition. (Emphasis supplied.)

(1231)

The record in the instant case does not show that any of the ships suffered from any defects prior to strapping. Hence, the strapping did not "restore" or "mend."

While petitioner recognizes that the strapping may not have been done to correct an existing infirmity, it claims that the work did not increase the value or prolong the life of the ships and that it was undertaken without choice as a result of a Government directive. The fact that the strapping was done as a result of a Government requirement does not lend any weight to petitioner's argument. In *Hotel Sulgrave, Inc.,* 21 T. C. 619 (1954), we held that the installation of a sprinkler system ordered by the Department of Housing and Building of the City of New York as

a safety measure constituted a capital expense rather than a repair. In *International Building Co.*, 21 B. T. A. 617 (1930), we required the capitalization of expenditures made to install safety devices in building elevators under the revised Code of the City of St. Louis. Similarly, the Court held that capitalization was necessary in *Lycoming Silk Co.*, 11 B. T. A. 523 (1928), when exposed wiring was enclosed in cable upon the order of the fire department.[7] While there is no absence of cases which have allowed as deductible repairs, expenditures incurred as a result of public authority requirements, such cases typically involve the correction of already existing infirmities determined by the public authority to be dangerous.

Petitioner lays great emphasis on the alleged fact that the strapping did not increase the value or prolong the life of the ships. It is true that most of the cases, including those relied upon by petitioner, which have held expenditures to be deductible repairs have relied upon the fact that the work did not result in an increase in valuation or prolongation of useful life. However, this does not mean that *unless* there is an increase in value or useful life the expenditure cannot be a capital expense. This is made clear in several cases. In *Hotel Sulgrave, Inc., supra,* we stated at page 621:

> The petitioner contends that the installation of the sprinkler system was a repair which was made for the purpose of keeping the hotel property in ordinarily efficient operating condition and which did not add to the value of the property or prolong

---

[7] See also *George Haiss Mfg. Co.*, 16 TCM 1106 (1957), where we held that the cost of safety devices installed pursuant to state law requirements were capital expenditures.

its life; and that the expenditure made therefor is an ordinary and necessary business expense deductible in the year ended June 30, 1950.

We do not agree that the installation of the sprinkler system constituted a repair made "for the purpose of keeping the property in an ordinarily efficient operating condition." Cf. *Illinois Merchants Trust Co.*, 4 B. T. A. 103, 106, cited by petitioner. It was a permanent addition to the property ordered by the city of New York to give the property additional protection from the hazard of fire. It was an improvement or betterment having a life extending beyond the year in which it was made and which depreciates over a period of years. While it may not have increased the value of the hotel property or prolonged its useful life, the property became more valuable for use in the petitioner's business by reason of compliance with the city's order. The respondent did not err in determining that the cost of this improvement or betterment should be added to petitioner's capital investment in the building, and recovered through depreciation deductions in the years of its useful life. *International Building Co.*, 21 B. T. A. 617, 621, and cases cited therein; *Difco Laboratories, Inc.*, 10 T. C. 660, 669.

The same point was clearly made in *Black Hardware Co.* v. *Commissioner, supra.* Furthermore, we are not entirely convinced by the record that the strapping operation involved in this case did not increase the life or the value of the ships.

We have given full consideration to the entire factual context of the instant case and the abundance of case au-

thority on this question.[8] The issue is not an easy one, but viewing the record as a whole and for the reasons discussed above, we hold that the strapping cost incurred in 1957 was a nondeductible capital expenditure.

As stated in our Findings of Fact, even though respondent determined that the strapping cost was a nondeductible capital expenditure, he did not in his notice of deficiency make an allowance for depreciation of this expenditure in 1957, the year the ships were sold. In view of our holding on the second issue in this case, that petitioner is entitled to deduct depreciation on

(1232)

its ships in 1957 up until the date of the sale, petitioner should similarly be allowed a 1957 depreciation deduction on the capitalized strapping cost. This adjustment may be made in the Rule 50 computation.

Decision will be entered under Rule 50.

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[8] For an exhaustive survey of the cases and a useful analytical discussion of the problem, see *Wriggins & Gordon, Repairs v. Capital Expenditures,* (1958).

APPENDIX C

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
***Moore-McCormack Lines, Inc.*, 44 T. C. 745 (1965)**

(745)

44 T. C. No. 71

TAX COURT OF THE UNITED STATES

Moore-McCormack Lines, Inc., Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket No. 2887—62. Filed August 27, 1965

1. Petitioner purchased 10 ships from a single seller by the issuance of 300,000 shares of its own previously unissued stock. The stock so issued constituted 13 percent of petitioner's outstanding stock thereafter. Two of the ships so purchased were immediately resold. *Held*: The basis to petitioner of the two ships resold is determined by the fair market value of the stock issued to purchase them; the fair market value of such stock was $30 per share.

2. *Held*: The cost basis, for purposes of computing depreciation of various other vessels, purchased in 1941, is the "statutory sales price" as calculated under section 9 of the Merchant Ship Sales Act of 1946. *Waterman Steamship Corporation* v. *United States*, 381 U. S. 252 (1965), controls.

Paul Edgar Swartz, William E. Stockhausen, and *Harold H. Meyers,* for the petitioner.

George T. Rita, for the respondent.

(746)

HOYT, *Judge*: Respondent determined a deficiency in income tax against petitioner in the amount of $663,519.48 for the taxable year 1957.

Excerpts From the Opinion of the Tax Court (Hoyt, J.) Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

The issues for decision are:

(1) What was the cost basis, for purposes of computing the correct amount of gain on sale, of two ships acquired by petitioner in 1957 for cash and stock, and resold in the same year?

(2) Is the cost basis, for purposes of computing depreciation, of various vessels purchased in 1941 the original purchase price as readjusted under section 9 of the Merchant Ship Sales Act of 1946 or the "statutory sales price" as calculated under the Act?

FINDINGS OF FACT

Some of the facts have been stipulated and the stipulation and exhibits attached thereto are hereby incorporated by reference.

Petitioner is a Delaware corporation with its principal office in New York City. It keeps its books and files its income tax returns on the accrual basis. It filed its 1957 calendar year income tax return with the district director, Manhattan District. Petitioner is a publicly owned shipping company whose common stock is, and was at all times here pertinent, traded on the New York Stock Exchange.

Facts Common to This Case and to Docket No. 3105—62, Seas Shipping Co.

On March 1, 1957, Moore-McCormack Lines, Inc. (hereinafter sometimes referred to as Mooremac), entered into a contract with Seas Shipping Co., Inc. (hereinafter sometimes referred to as Seas), which operated a shipping fleet known as the Robin Line. This contract provided for the purchase by Mooremac from Seas of 12 vessels for a total purchase price of $17,000,000, payable $3,200,000

in cash, $4,800,000 in cash or promissory notes at option of Mooremac and $9,000,000 by 300,000 shares of Mooremac's common stock. The vessels were described in the contract as follows:

Name	Type	Year Built
SS *Robin Locksley*	C-2S	1941
SS *Robin Wently*	C-2S	1941
SS *Robin Tuxford*	C-2S	1941
SS *Robin Sherwood*	C-2S	1941
SS *Robin Kettering*	C-2S	1941
SS *Robin Doncaster*	C-2S	1941
SS *Robin Goodfellow*	C-3	1945
SS *Robin Gray*	C-3	1943
SS *Robin Hood*	C-3	1945
SS *Robin Kirk*	C-3	1943
SS *Robin Mowbray*	C-3	1943
SS *Robin Trent*	C-3	1943

(747)

Pertinent provisions of the contract are set forth below:

> 5. Delivery of Vessels: Each Vessel shall be delivered to BUYER * * * promptly on completion of its voyage in progress on April 15, 1957. * * *
>
> * * *
>
> 7. Purchase Price and Payment Thereof:
>
> (a) As and for the purchase price of the Vessels, the BUYER shall pay and deliver to SELLER the following:
>
> (1) Cash .....$3,200,000.
>
> (2) Three Hundred Thousand (300,000) shares of BUYER's duly authorized Common Stock (par value $12 per share).

Excerpts From the Opinion of the Tax Court (Hoyt, J.) Moore-McCormack Lines, Inc., 44 T.C. 745 (1965)

(3) At BUYER's option, cash or promissory notes of Buyer, as more particularly described hereinafter, in the amount of $4,800,000. By mutual agreement some or all of said sum of $4,800,000 may be paid in additional shares of BUYER's duly authorized Common Stock (par value $12 per share).

(b) The purchase price shall be payable as follows:

(1) On delivery of the *Robin Goodfellow,* there shall be paid in cash out of BUYER's Capital Reserve Fund the sum of $1,600,000 for such Vessel.

(2) On delivery of the *Robin Hood,* there shall be paid in cash out of BUYER's Capital Reserve Fund the sum of $1,600,000 for such Vessel.

(3) Upon delivery of the first of the Vessels to be delivered, BUYER will issue and deposit in escrow with The Chase Manhattan Bank, New York, New York * * * Three Hundred Thousand (300,000) shares of its duly authorized Common Stock. * * *

(4) Such escrow agreement shall, among other things, provide that on receipt by the Bank of notice from BUYER and SELLER jointly that one or more of the Vessels has been delivered by Seller and accepted by BUYER, said Three Hundred Thousand (300,000) shares of Common Stock shall be delivered by the Bank to SELLER or upon its written order in payment for the Vessels of the C-2S type unless excepted as provided in Article 10 hereof, upon delivery thereof, and, to the extent that such shares shall not be deliverable in payment for Vessels of the C-2S type as hereinabove provided, in payment for Vessels of the C-3 type (except the *Robin Hood*

and the *Robin Goodfellow*) in the order of their delivery.

(5) For purposes of paragraph (4) above, said Three Hundred Thousand (300,000) shares of Common Stock shall be delivered to SELLER or on its written order at the rate of one full share thereof for each $30, or fraction thereof, of value of the Vessels hereinafter set forth opposite their respective names, as follows:

Name of Vessel	*Value*
SS *Robin Locksley*	$ 1,266,667
" *Wently*	1,266,667
" *Tuxford*	1,266,667
" *Sherwood*	1,266,667
" *Kettering*	1,266,666
" *Doncaster*	1,266,666
" *Gray*	1,550,000
" *Kirk*	1,550,000
" *Mowbray*	1,550,000
" *Trent*	1,550,000
	[$13,800,000]

(748)

(6) Subject to the final sentence of paragraph (a)(3) of this Article 7, the balance of the purchase price of the Vessels shall be payable, at BUYER'S option, either in cash or in serial promissory notes of BUYER, or partly in cash and partly in such notes. * * *

* * *

8. Conditions to Sale: Anything herein to the contrary notwithstanding the purchase herein pro-

vided for is and shall be subject to full compliance on or before April 15, 1957 with the following conditions precedent:

(a) Approval by the Federal Maritime Board and/or Maritime Administration of the sale of the Vessels on the terms and conditions herein contained;

* * *

(g) * * * [T]he listing by the New York Stock Exchange of the Three Hundred Thousand (300,000) shares of such Common Stock issuable in payment of part of the purchase price as herein provided;

* * *

10. Exception of Vessels from Sale: At the option of Buyer, exercisable by written notice delivered to Seller prior to delivery of the first Vessel hereunder, there shall be excepted from the purchase herein provided for the SS *Robin Kettering* or the SS *Robin Doncaster,* or both. In such event, any such Vessel so designated shall be excluded from the sale herein provided for, and the cash or promisssory notes of BUYER payable as provided in Article 7(a)(3) hereof shall be reduced by $1,266,666 for each Vessel so excluded.

* * *

12. Purchase for Investment: SELLER represents, warrants and covenants that it is acquiring the shares of Common Stock of BUYER solely for investment and not with a view to the resale or further distribution thereof.

Excerpts From the Opinion of the Tax Court (Hoyt, J.) Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

13. Force Majeure: (a) * * *

(b) In the event, after delivery of any one of the Vessels, SELLER shall be unable to deliver, or BUYER shall be unable to accept delivery of, one or more of the Vessels due to restraints of governments, principalities, nations or the United Nations, or other reasons that may be brought about by causes beyond the reasonable control of either party, this Agreement shall not terminate, but the purchase price of the Vessels shall be reduced by the value of the Vessel or Vessels not delivered. For the purpose of this paragraph, the SS *Robin Hood* and SS *Robin Goodfellow* shall be deemed to have a value of $1,600,000 and the other Vessels shall be deemed to have the values set opposite their respective names in Article 7(b)(5) hereof. Such reduction of purchase price shall, with respect to the non-delivery of the SS *Robin Hood* and/or SS *Robin Goodfellow*, be applied to reduction of the cash amounts payable as provided in Articles 7(b)(1) and 7(b)(2) hereof and, with respect to the non-delivery of any of the other Vessels, shall be applied first in reduction of the cash or promissory notes set forth in Article 7(a)(3) hereof and then in reduction of the shares of Common Stock set forth in 7(a)(2) hereof.

On March 1, 1957, contemporaneously with the execution of the above-described contract of sale, Seas entered into a stockholders' agreement with certain principal stockholders of Mooremac under which it was agreed that the parties to the agreement would vote their stock to elect directors two of whom were to be nominated by Seas and

the remaining seven by a majority of the parties to the agreement. This agreement was to continue in effect for 5 years or until Seas

(749)

ceased to own beneficially at least 100,000 shares of Mooremac's stock, whichever event first occurred.

Also on March 1, 1957, contemporaneously with the agreement of sale and the stockholders' agreement, Mooremac entered into a "memorandum of understanding" with Seas which provided, *inter alia*, that Mooremac would continue to employ certain key men of Seas. Mooremac, however, was not required to employ these persons for any specific length of time. The memorandum of understanding also required that Mooremac continue to use the name "Robin Line" for a period of five years on the ships purchased. It was agreed that the contract of sale and the stockholders' agreement as well as the memorandum of understanding would be considered as interrelated and complementary one to another.

On March 11, 1957, both parties submitted the contract of sale to the Federal Maritime Board for approval, as required by law. On April 25, 1957, the Federal Maritime Board notified the parties of its approval. In this notice of approval some of the principal terms of the contract were recited. Among the terms so recited was the designated dollar selling price for each ship and the provision for partial payment in shares at a designated rate of $30 per share. As required by its terms, both Mooremac and Seas filed their unqualified acceptance of the Federal Maritime Board's order of approval, on April 30, 1957.

Under Article 10 of the contract of sale, as quoted above, Mooremac had the right to exclude two ships, the *Robin Kettering* and the *Robin Doncaster* from the trans-

action. On April 11, 1957, Mooremac exercised its option to exclude both vessels from the purchase. Thereafter, Seas sold these two ships, which had been ascribed values in the contract of sale to Mooremac of $1,266,666 each, to unrelated third parties for $1,350,000 each.

On May 1, 1957, Mooremac, Seas Shipping and The Chase Manhattan Bank entered into the escrow agreement referred to in the vessel purchase agreement and Mooremac deposited with Chase Manhattan 300,000 shares of its common stock in the name of Seas Shipping. The escrow agreement provided, *inter alia,* as follows:

> 2. Disposition of Stock—
>
> 2.01 Subject to the provisions of Section 2.04, the Escrow Agent shall deliver to The Chase Manhattan Bank, Corporate Trust Department, Transfer Agent, and to Chemical Corn Exchange Bank, Registrar, for countersignature and registration, respectively, and thereafter to the Seller, or upon its written order, in payment on account of the purchase price of the following Vessels to be pur-
>
> (750)
>
> chased by Buyer, the number of shares of Stock set opposite their respective names:

Name of vessel	*Number of shares*
SS *Robin Wentley*	28,667
" *Locksley*	42,223
" *Tuxford*	42,223
" *Sherwood*	42,223
" *Trent*	51,666
" *Mobray*	51,666
" *Gray*	20,666
" *Kirk*	20,666

Excerpts From the Opinion of the Tax Court (Hoyt, J.) Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

2.02 In the event that the Seller shall be unable to deliver, or the Buyer shall be unable to accept delivery of, one or more of the Vessels specified in Section 2.01 hereof and the Buyer and the Seller, jointly, shall notify the Escrow Agent to that effect, then, and in any such event, the shares of Stock otherwise deliverable in payment on account of the purchase price of the Vessel or Vessels not so delivered and accepted shall, subject to the provisions of Section 2.04, be disposed of by the Escrow Agent as follows:

A. By delivery to the Seller, or upon its written order, in payment first on account of the purchase price of the SS *Robin Wentley,* if not then yet delivered, of 13,556 additional such shares and then on account of the purchase price of the SS *Robin Kirk* and/or SS *Robin Gray,* if either or both of said Vessels shall not then yet have been delivered, of up to 31,000 additional such shares for each such Vessel; or

B. To the extent that such shares are not applied on account of the purchase price of Vessels thereafter delivered, by delivery to the Seller, or upon its written order, in prepayment on account of the principal of any notes theretofore delivered, in accordance with the Purchase Agreement, by the Buyer to the Seller on account of the purchase price of any Vessel, such prepayment to be at the rate of $30 for each share of Stock so delivered.

2.03 The balance of any shares of Stock held by the Escrow Agent, after application thereof as

provided in Sections 2.01 and 2.02, shall be delivered by the Escrow Agent to the Buyer, or upon its written order.

2.04 The Buyer and the Seller, jointly, shall notify the Escrow Agent from time to time as and when Vessels shall be delivered by the Seller and accepted by the Buyer, and, promptly upon receipt of such notice, the Escrow Agent shall deliver the shares of Stock deliverable pursuant to Section 2.01 or clause A of Section 2.02 on account of the purchase price of the Vessel specified in such notice. The Buyer and the Seller, jointly, shall instruct the Escrow Agent from time to time as to dispositions, if any, of the Stock to be made pursuant to clause B of Section 2.02 or Section 2.03, and promptly upon receipt of any such instructions, the Escrow Agent shall deliver to the Seller, or the Buyer, as the case may be, or upon their respective written orders, the shares of Stock deliverable pursuant to said Sections. The Buyer and the Seller shall deliver to the Escrow Agent all documents necessary to effect delivery of any Shares deliverable hereunder.

Pursuant to the aforesaid contract of sale and the escrow agreement, the ships subject to the contract (other than the two ships excluded as mentioned above) were delivered by Seas and paid for by Mooremac as follows:

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

(751)

Ship	Date of Delivery	Cash	Notes	Shares of Stock
SS *Robin Goodfellow*	6/ 5/57	$1,600,000		
SS *Robin Gray*	6/14/57		$ 930,000	20,666
SS *Robin Hood*	6/18/57	1,600,000		
SS *Robin Kirk*	7/31/57		930,000	20,666
SS *Robin Locksley*	6/24/57			42,223
SS *Robin Mowbray*	5/17/57			51,666
SS *Robin Sherwood*	5/27/57			42,223
SS *Robin Trent*	5/ 3/57			51,666
SS *Robin Tuxford*	6/25/57			42,223
SS *Robin Wentley*	8/ 9/57	406,668		28,667
Totals		$3,606,668	$1,860,000	300,000

Pursuant to contracts made in April of 1957, Mooremac resold the SS *Robin Tuxford* and the SS *Robin Wentley* to unrelated third parties for $1,350,000 each. These ships were sister ships and also were sister ships to the *Doncaster* and *Kettering* sold about the same time by Seas for the same price.

The 300,000 shares of stock issued to Seas under the contract of sale made Seas the largest single stockholder of Mooremac; as of the end of 1957 this amounted to approximately 13 percent of Mooremac's outstanding stock. During 1957 Mooremac's Chairman of the Board, Emmet J. McCormack, held 212,360 shares and this was the second largest shareholding. There were 140,000 shares held by Dollar Associates, Inc. Seas acquired its stock as an investment and at the time of trial in the instant case continued to hold the 300,000 shares received on the sale its vessels to Mooremac.

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

The book value of Mooremac's stock was $39.13 as of December 31, 1956, and $39.15 as of December 31, 1957.

Mooremac stock was traded on the New York Stock Exchange at a small volume during the period from March 1, 1957, to August 9, 1957, and at an average of 387 shares per day on the eight days on which ships were delivered to Mooremac in exchange for stock. There was only slight fluctuation in the average selling price as indicated by the following table:

Date or Period	High Selling Price	Low Selling Price	Average (Mean) Selling Price	No. of Shares Traded
1957				
March	23⅞	21⅝	22.75	12,100
May 3	23½	23½	23.5	300
May 17	23⅞	23¾	23.8125	500
May 27	22¾	22⅝	22.6875	300
June 14	22¼	22¼	22.25	100
June 24	22¼	22⅛	22.1875	300
June 25	22¼	22¼	22.25	100
July 31	22¾	22⅜	22.5625	1,200
Aug. 9	22½	22	22.25	300

During the year 1957 a total of 166,000 shares of Mooremac stock was traded on 237 of the 252 trading days on the New York Stock Exchange. The highest price at which Mooremac stock has been traded

(752)

On the New York Stock Exchange to date of trial was 25¼ in January and February 1957.

Excerpts From the Opinion of the Tax Court (Hoyt, J.) Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

Other Facts Related to the Purchase of Ships From Seas Shipping Company

Shortly after the contract of sale was entered into Mooremac, on April 15, 1957, made application to the New York Stock Exchange for listing of the 300,000 new shares of its common stock to be issued to Seas. In this application the following statement was made:

> The vessels will be charged at cost to fixed assets. The Common Stock issuable pursuant to the Agreement will be capitalized at $30 per share, deemed to be the fair market value thereof.

The application for listing was approved and the shares were listed.

In the letter of April 11, 1957, addressed to Seas Shipping, in which Mooremac exercised its option to exclude the *Robin Kettering* and the *Robin Doncaster* from the transaction the concluding sentence was as follows:

> In accordance with the terms of such Purchase and Sale Agreement, the purchase price for the remaining vessels to be purchased by us is, therefore, reduced by the aggregate sum of $2,533,332 to $14,466,668.

The purchase of the ten vessels from Seas was recorded on Mooremac's books at $14,466,668. Mooremac's 1957 annual report contained financial statements audited by Arthur Anderson & Co. One of the notes to the financial statements contains the following:

> In addition, the Company acquired four C-2 type and six C-3 type cargo vessels from the Seas Ship-

ping Company, Inc., for a total purchase price of $14,467,000. Of the amount paid $9,000,000 was represented by the issuance of 300,000 shares of the Company's common stock and the balance by cash and first preferred ship mortgages. Two of the C-2 type cargo vessels which represented aggregate cost of $2,533,000 were subsequently sold resulting in a profit of approximately $54,000 net of Federal income taxes.

Including the sale by Seas of the *Doncaster* and the *Kettering,* at least nine ships similar to those purchased by Mooremac from Seas changed hands in the open market at about the same time as the sale to Mooremac and at comparable prices. Three C-2 type vessels were purchased by the Grace Line, one for $1,350,000 and the other two for $1,335,000 each (for future delivery). Four C-3 type vessels were purchased by Mooremac from Pacific Argentina Brazil Line, Inc., an unrelated corporation, for $1,625,000 each. The names of these ships, the year built and the date of delivery are as follows:

Original Name	New Name	Year Built	Date of Delivery
Pathfinder	*Mormacsun*	1943	2/14/57
Forester	*Mormacwave*	1944	3/20/57
Trader	*Mormacguide*	1944	4/ 4/57
Seafarer	*Mormacwind*	1944	4/25/57

(753)

The purchase price of $1,625,000 each was paid in cash and was from $25,000 to $75,000 in excess of the stated contract price for comparable vessels purchased from Seas.

The two sales which give rise to the issue presented here are the sale by petitioner of the *Robin Tuxford* and

the *Robin Wentley* to wholly unrelated corporations. These sales were both made under contracts entered into on April 30, 1957, which provided for closing of the transactions when the ships were delivered to Mooremac by Seas Shipping. The *Tuxford* sale was consummated on June 25, 1957, the same day that Seas delivered that vessel to petitioner, and petitioner incurred deductible expenses in connection with that sale of $32,046.35. The sale of *Wentley* was consummated on August 9, 1957, the same day that Seas delivered that vessel to petitioner, and petitioner incurred deductible expenses in connection with that sale in the amount of $35,634.36. As indicated above, the Mooremac-Seas contract price for *Wentley* and *Tuxford* was $1,266,667 each; sale of the Tuxford was accomplished by delivery to Seas of 42,223 shares of Mooremac stock, and petitioner paid $406,668 in cash and 28,667 shares of stock for *Wentley*. The fair market value of the *Tuxford* and *Wentley* transferred to petitioner by Seas Shipping in exchange for cash and shares of petitioner's stock was at least $1,266,667 for each vessel.

In its income tax return for 1957, petitioner reported these sales of the two vessels as short-term capital gains as follows:

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

Description	Date acquired and date sold	Gross sales price	Cost or other basis	Expense of sale	Gain
Vessels:					
Robin Tuxford	April 30, 1957	$1,350,000	$1,266,667	$32,046.35	$51,286.65
Robin Wentley	April 30, 1957	1,350,000	1,266,667	35,634.36	47,698.64

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

Respondent, in his deficiency notice, determined that the short-term gain realized on these sales was $1,374,984.29 computed as follows:

	Robin Wentley	Robin Tuxford	Total
Selling price of vessels	$1,350,000.00	$1,350,000.00	$2,700,000.00
Less: expense of sale	35,634.36	32,046.35	67,680.71
Net selling price	$1,314,365.64	$1,317,953.65	$2,632,319.29
Cost basis of vessels:			
Cash	406,668.00	—	406,668.00
Common stock			
28,666 19/30 sh. at $12.00	344,000.00	—	344,000.00
42,222 7/30 sh. at $12.00	—	506,667.00	506,667.00
Total cost basis	750,668.00	506,667.00	1,257,335.00
Gain realized	$ 563,697.64	$ 811,286.65	$1,374,984.29

(754)

No explanation for the $12.00 per share valuation ascribed to Mooremac's stock by the respondent is made but it apparently derives from the fact that the stock has a $12.00 par.

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

FINDINGS OF ULTIMATE FACT

The stock transferred by Mooremac to Seas as part of the purchase price of these ships had a fair market value of $30 per share.
(756)

* * * *

OPINION

The first issue in this case concerns petitioner's basis in the two ships SS *Robin Tuxford and* SS *Robin Wentley,* which were purchased and resold in the year 1957. Under section 1011 of the Internal Revenue Code of 1954, the adjusted basis for determining gain or loss on the sale of property is the basis determined under section 1012 (as adjusted under section 1016 for depreciation, etc.). Section 1012 provides:

> The basis of property shall be the cost of such property. * * *

Section 1.1012-1 of the Regulations provides:

> In general, the basis of property is the cost thereof. The cost is the amount paid for such property in cash or other property. * * *

In the instant case, to determine the amount paid for the ships in dollars, it is necessary to determine the value in dollars of the shares of stock given in payment.

In its 1957 income tax return, petitioner reported short-term gain on the sale of these two ships in the total amount of $98,985.29. This gain was computed on a cost of $1,266,667 for each ship, which was the designated value in the contract of purchase from Seas and which was based on

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

a value of $30 per share for the stock issued in payment, plus the cash paid.

Seas Shipping Company, in reporting its gain on the 1957 sale of ships to petitioner, valued the petitioner's stock received in payment at only $19.90 per share. This valuation was also challenged by the Commissioner, who in that instance determined that the value of the stock was $39.17 per share, and Seas is contesting his action in a separate case in this Court—Docket No. 3105-62. Respondent has taken a protective position between the two parties and in his briefs in the instant case, as well as in Docket No. 3105-62, he restates the arguments of both Moore-McCormack and Seas Shipping and argues his own position that the value of the stock given in payment for the ships was $22.81 per share, based on trading prices on the New York Stock Exchange. Respondent's ultimate request is that whatever we deter-

(757)

mine the value to be we should find the same valuation for the stock in both cases.

Since the record here indicates that the petitioner and Seas, both knowledgeable and experienced ship operating companies, were dealing at arm's length in the transaction here involved, it is entirely logical to presume that the value of the stock and cash given up by petitioner was equal to the value of the ships received. *Philadelphia Park Amusement Co.* v. *United States,* 126 F. Supp. 184 (Ct. Cl. 1954). Therefore, even though there is available in this case direct evidence of prices at which the previously outstanding shares of petitioner were traded in small volume on the stock exchange, which evidence might permit a determination of the value of the shares issued in payment for the ships without any reference to the values of the ships

received, obviously, evidence of the value of the ships received is of great importance in determining the value of the stock exchanged. *Amerex Holding Corporation*, 37 B. T. A. 1169 (1938), affirmed per curiam 117 F. 2d 1009 (C. A. 2, 1941), certiorari denied 314 U. S. 620; Rev. Rul. 55-443, 1955-2 C. B. 562, 565.

In *Amerex, supra*, at page 1190, we observed:

> If therefore it appears from the record that the value of the property received, upon the issuance by a corporation of certain of its shares of stock, is the best evidence of the fair market value of those shares at the time of issue, that evidence should be applied and the fair market value of the shares of stock issued determined accordingly, even though at the time of issuance the corporation already owned substantial property of value and had other shares of stock outstanding.

In the written contract of sale each of the ships is assigned a dollar value. We are certainly well aware and mindful that the agreement of the parties fixing or allocating value of assets to be sold or exchanged is not controlling as a determination by which we are bound in determining the tax consequences. *Meister* v. *Commissioner*, 302 F. 2d 54 (C. A. 2, 1962), affirming a Memorandum Opinion of this Court. There is nothing in the record here, however, to indicate that the values so assigned for purposes of the contract were other than the actual fair market values of the ships recognized as such by the parties. In fact, there is an abundance of evidence which makes it apparent that the ships were in fact worth the amounts specified in the contract, if not more.

One of petitioner's witnesses was a ship broker of considerable experience who had acted as broker in the sale by

Seas of the *Robin Doncaster* and the *Robin Kettering* to third parties after petitioner had exercised its option to exclude those two ships from its contract of purchase, and also in the sale of the sister ships *Robin Tuxford* and *Robin Wentley* to third parties in 1957. This broker, who was thoroughly familiar with the ships sold by Seas to petitioner, testified that

(758)

at the time of the sales of the *Tuxford* and the *Wentley* to petitioner, these ships were worth not less than the $1,266,667 specified for each of them in the contract.

The correctness of the value specified in the contract is further supported by the fact that several other vessels of comparable types to those sold to petitioner changed hands in the open market, at approximately the same time as the sales to petitioner, at prices which were very closely comparable to the values placed on the Robin Line ships in the contract of sale to petitioner. In fact, the two ships omitted at petitioner's option from the contract were sold very shortly thereafter by Seas to third parties at prices in dispute in this case (the *Tuxford* and the *Wentley*) were resold by petitioner on the same day they were received, for prices in excess of the values assigned in the purchase contract.

Finally, strong evidence that the parties regarded values assigned in the contract as the true fair market value of the ships is found in the provisions of Articles 10 and 13 of the contract itself. These articles provide for possible elimination of ships from the group being sold, under certain circumstances. If such an elimination occurs the assigned value of the ship eliminated is applied to reduce the cash and notes to be paid under the contract. Thus, if a ship assigned a value of $1,266,667 is not delivered, and is eliminated from the transaction, the cash and promissory

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

notes to be received by Seas from the entire contract is reduced by $1,266,667 as the true value of the eliminated ship. This is exactly what transpired when Mooremac exercised its option under section 10 and notified Seas at the same time that accordingly the purchase price for the remaining vessels "is, therefore, reduced by the aggregate sum of $2,533,332 to $14,466,668." The reduction thus effected was all in the cash and notes so that the total paid by Moremac by cash and notes was only $2,666,668 instead of $4,800,000 specified by the contract. Since all of the ships were subject to possible elimination from the contract under Article 13 (the "Force Majeure" clause) with a resulting diminution of the cash and notes to their entire extent, the values specified in the contract indicate the true fair values of the ships.

We hold that the ships purchased by petitioner from Seas were worth no less at the time of purchase than the values assigned to those ships in the contract of sale executed by petitioner and Seas. Though of basic importance, the value of the ships received is not conclusive evidence of the value of the stock issued in exchange therefor in a situation where the market price of previously outstanding stock of the issuer trading on a stock exchange is available as direct evidence of the value of the stock itself. *Pierce Oil Corporation,* 32 B. T. A. 403 (1935); Rev. Rul. 56-100, 1956-1 C. B. 624.

(759)

Petitioner's stock is traded on the New York Stock Exchange. Stock market quotations have been held to be the best evidence of value of a traded stock in a great number of cases. See, e.g., *W. T. Grant Company* v. *Duggan,* 94 F. 2d 859 (C. A. 2, 1938); *Hazeltine Corporation* v. *Commissioner,* 89 F. 2d 513 (C. A. 3, 1937), affirming 32

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

B. T. A. 4 (1935); *Union National Bank of Pittsburgh* v. *Driscoll,* 32 F. Supp. 661 (W. D. Pa., 1940).

The weighted average price at which petitioner's stock traded on the New York Stock Exchange on the dates of delivery of each of the ships purchased was $22.81. It is respondent's contention that $22.81 is the appropriate per share valuation of the stock issued by petitioner to Seas in exchange for the ships purchased. While we are quick to recognize the persuasive importance of stock exchange prices in a stock valuation case such as the instant one, nonetheless, we are convinced that we must carefully consider all of the evidence in the record which indicates the true fair market value for the 300,000 shares here involved. See *Heiner* v. *Crosby,* 24 F. 2d 191 (C. A. 3, 1928), in which the court stated, at page 193:

> Sales made at a particular time and place may be significant, but the price paid is not necessarily decisive of fair market price or value. The fact of sales, in itself and without regard to the circumstances under which the sales were made, does not conclusively establish either statutory fair market price or value. Sales made under peculiar and unusual circumstances, such as sales of small lots, forced sales, and sales in a restricted market, may neither signify a fair market price or value, nor serve as the basis on which to determine the amount of gain derived from the sale.

Similarly, sales in 100-share lots under ordinary circumstances on a stock exchange may not serve as a reliable yardstick or measure of value in the very extraordinary circumstance of the issuance of 300,000 shares representing over 13 percent of the outstanding stock of a corporation and almost twice as many shares as were traded in the

entire year of issuance. See *Maytag* v. *Commissioner*, 187 F. 2d 962 (C. A. 10, 1951), affirming a Memorandum Opinion of this Court; accord, *Safe Deposit & Trust Co. of Baltimore*, 35 B.T.A. 259 (1937), affd. 95 F. 2d 806, 812 (C.A. 4, 1938); *James Couzens*, 11 B. T. A. 1040, 1161 (1928).

Of paramount importance in our rejection of the mean stock market trading price as determinative of value here is the fact that what we are called upon to value is not a few hundred or even a few thousand isolated shares which can be easily valued by a determination of how much cash they could be readily converted into in the established market. Rather, we must value a lump, a block, an integrated package or bundle of rights representing ownership of 13 percent of a large and successful corporation. We must think not in terms of 300,000 individual shares of stock at so many dollars per share, but in terms of the overall dollar value of ownership of 13 percent of Moore-McCor-
(760)
mack Lines, Inc., with the shares of stock meaningful not as something which can be converted to cash but merely as the formal evidence of ownership of the 13 percent. Cf. *Heiner* v. *Crosby, supra;* accord, *Perlman* v. *Feldmann*, 219 F. 2d 173 (C. A. 2, 1955), certiorari denied, 349 U. S. 952 (1955).

The shares which were received by Seas were received with certain additional rights and privileges which did not attach to the shares which changed hands on the stock exchange. The 300,000-share block received by Seas carried with it a promise by petitioner to continue to operate the Robin Line and to employ certain of Seas' key men "in positions carrying responsibility and compensation comparable to that which they have enjoyed * * * in the employ of [Seas]." It also carried the guarantee of petitioner's controlling shareholders that the 300,000 shares

in the hands of Seas would control two seats on the board of directors for at least five years. These rights had some value above and beyond the value of the stock alone, as reflected in stock exchange prices, absent such collateral rights, and, hence, the mean stock exchange price is not determinative of the overall value of the 300,000 shares coupled with the bundle of collateral rights involved in this case. In the circumstances it is not unreasonable that the size of the block involved plus the collateral rights received in the transaction resulted in a per share value over $7 in excess of the weighted average stock exchange price of $22.81.

We note further that the volume of trading in Mooremac stock on the New York Stock Exchange at the time in question was very light. In May 9,000 shares were traded; in June 5,800 shares; in July 15,500 shares; and in August 11,100 shares. Only 166,000 shares changed hands in all of 1957. This lightness in the volume of the trading which was at an average price of $22.81 per share somewhat dilutes the persuasiveness of that average per share price as reliable evidence of the value of a block of 300,000 shares.

When a block of stock as large as 13 percent is purchased the net asset value (or book value) of the stock becomes an important consideration. The book value of petitioner's stock at the time of purchase of the ships was in excess of $39 per share. This fact further supports petitioner's contention that the $22.81 mean stock market price is too low to be regarded as the per share value of the 300,000 shares here involved. Each of the 300,000 shares issued to Seas was backed by net assets worth more than $39.

To hold that the stock issued to Seas was worth only $22.81 per share would produce an anomalous situation.

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

The purchase price specified in the contract of $1,266,667 for the *Tuxford* was paid by the issuance of 42,223 shares of stock, and the same purchase price for the *Wentley* was paid by the issuance of 28,667 shares of stock plus $406,668 in cash. If the stock were valued, as the respondent suggests,

(761)

at only $22.81 per share instead of $30, as petitioner valued it, the cost of the *Tuxford* would be $963,106 while the cost of the *Wentley* would be $1,060,562. This disparity is unrealistic in view of the fact that the two ships were sister ships of the same type, built at the same time, were assigned equal values in the contract of sale to petitioner, and were sold immediately upon delivery for equal amounts by petitioner.

Finally, the evidence is plentiful that both parties in their dealings with third parties and stockholders gave every indication that they regarded the stock as worth $30 per share. Both parties submitted the contract for approval to the Federal Maritime Board and accepted the Board's approval which contained a recitation of the provisions that shares of petitioner were to be accepted at a rate of $30 per share.

The Board's approval, accepted unconditionally by both petitioner and Seas Shipping, authorized Seas to sell and Mooremac to purchase the ten vessels "to be paid for by Moore-Mac" as follows:

Excerpts From the Opinion of the Tax Court (Hoyt, J.)
Moore-McCormack Lines, Inc., 44 T. C. 745 (1965)

1. SSs *Robin Goodfellow* and *Robin Hood* in cash to be withdrawn from Moore-Mac's Capital Reserve Fund		$ 3,200,000
2. SSs *Robin Tuxford* and *Robin Locksley* at $1,266,667 each:		
Mortgage to Seas	$2,266,669	
8888.8 shares Common Stock at $30.00 per share	266,665	2,533,334
3. The following vessels with 291,111.2 shares of Common Stock to be issued to Seas at $30.00 per share:		
SS *Robin Sherwood*	$1,266,667	
SS *Robin Wentley*	1,266,668	
SS *Robin Gray*	1,550,000	
SS *Robin Kirk*	1,550,000	
SS *Robin Mowbray*	1,550,000	
SS *Robin Trent*	1,550,000	8,733,335
	Total	$14,466,669

That both petitioner and Seas Shipping recognized that the total contract price for the ten vessels was $14,466,668[9] is apparent from their unqualified acceptance of all of the provisions contained in the Maritime Board's authorizing letter of approval of the sale dated April 25, 1957. The total approved price to be paid by petitioner to Seas was $14,466,669. A sale of the vessels at that price was the only sale ever authorized by the Federal Maritime Board under the 1916 Shipping Act.

Petitioner represented to the New York Stock Exchange in an application for listing of the shares to be issued to Seas, apparently without objection by Seas, that the fair

market value of the shares to be issued was $30 per share. In its annual report to shareholders for 1957,
(761)
audited by a nationally known firm of accountants, the purchase of the ships from Seas was reflected in such a way on both the assets and the stockholders' equity sections of the balance sheet as to indicate that the stock issued pursuant thereto was issued at a value of $30 per share. In a note to its 1957 financial statements petitioner represented to its shareholders that the aggregate purchase price of the ten ships was $14,467,000, a figure which assumes a value of $30 per share for the stock issued. In the letter from petitioner to Seas in which petitioner exercised its option to exclude the *Doncaster* and the *Kettering* from the contract petitioner referred to the remaining aggregate price for all the ships in terms only of dollars—not in terms of dollars and shares—with shares apparently converted to dollars at a rate of $30 per share. Hence, it appears abundantly clear that, both in the contract itself and thereafter in dealings with third parties and with each other, both of the parties to the contract at all times regarded the 300,000 shares of stock as worth $30 per share.

In finding as an ultimate fact that the 300,000 shares of petitioner's stock issued to Seas in 1957 in exchange for ships of the Robin Line were worth $30 per share, we have carefully examined and weighed all of the evidence submitted by both parties. We have done our best to give to each bit of evidence the weight to which it is entitled in using our best judgment to find fair market value. Based upon all of the evidence before us thus considered and applying our reasoned finding of fair market value to the issue before us, we hold that the cost basis to petitioner of the SS *Robin Tuxford* was $1,266,690, and the cost basis to petitioner of the SS *Robin Wentley* was $1,266,678.[3]

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[3] The slight dollar discrepancy is not explained by the record which as our findings indicate showed payment of 42,223 shares of stock for *Tuxford* and 28,667 shares of stock, plus $406,668 in cash for *Wentley*.